

Docket:	<u>A.04-09-019</u>
Exhibit Number	<u>:</u>
Commissioner	<u>Michael R. Peevey</u>
Admin. Law Judge	<u>Bert Patrick</u>
DRA Project Mgr.	<u>Diana S. Brooks</u>



**DIVISION OF RATEPAYER ADVOCATES  
CALIFORNIA PUBLIC UTILITIES COMMISSION**

**Report on the Application  
of  
California American Water Service  
for  
Coastal Water Project Interim Rate Relief**

Application Number  
A.04-09-019

*San Francisco, California  
June 19, 2006*

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## MEMORANDUM

This report was prepared by Diana Brooks of the Division of Ratepayer Advocates (DRA) of the California Public Utilities Commission (Commission) in the *California American Water Company Coastal Water Project Application for a Certificate of Public Convenience and Necessity to Construct and Operate Its Coastal Water Project to Resolve the Long-term Water Supply Deficit in its Monterey District and to Recover All Present and Future Costs in Connection Therewith in Rates*, A. 04-09-019, filed September 20, 2004. In the first phase of this docket, the applicant, California American Water Company ("Cal Am or CAW"), requests surcharges to recover its Coastal Water Project (CWP) preconstruction costs and to collect customer contribution revenues to offset the future cost of the CWP or alternative water supply project. In this report DRA presents its analysis and recommendations associated with the applicant's request.

The Cal Am Coastal Water Project interim rate relief request touches on a number of important policy issues – water supply, efficient water use, infrastructure investment, requiring customers to pay for preconstruction costs for plant which has not yet been permitted or placed in service, and affordability of water service for both regular and low income customers. These are all related to key objectives in the Commission's recently adopted Water Action Plan.<sup>1</sup> DRA addresses the broader policy implications of these issues as they relate to the Cal Am's interim rate request in this report.

Diana S. Brooks served as DRA's project manager for Cal Am's Coastal Water Project Application, and is responsible for the overall coordination in the preparation of this report. Her prepared qualifications and testimony are contained in Appendix A of this report. Zara Clayton-Niederman, a graduate student intern in City Planning at the University of California Berkeley, provided technical and analytical support for this report.

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<sup>1</sup> Water Action Plan, CPUC, December 15, 2005. See [http://www.cpuc.ca.gov/static/hottopics/3water/water\\_action\\_plan\\_final\\_12\\_16\\_05.pdf](http://www.cpuc.ca.gov/static/hottopics/3water/water_action_plan_final_12_16_05.pdf)

# DRA Report on the California American Water Company

## Interim Rate Relief Proposal

### I. Summary of DRA Recommendations

DRA is concerned about both the magnitude and pace of preconstruction costs incurred by Cal Am, especially given the uncertainty still surrounding the ownership structure and governance of the project. At this point, it is still uncertain if and when the Coastal Water Project will be built, or whether Cal Am will be the owner and operator of a Plan B type desalination facility, aquifer storage and recovery facilities and related complements.

Cal Am estimates CWP preconstruction costs will exceed \$21.3 million. It forecasts CWP construction costs at \$191 million. Net annual operating costs are estimated to be \$7.1 million in 2009. Cal Am estimates the additional annual revenue requirement for Monterey District once the Coastal Water Project comes online would be \$27 million to \$32 million.<sup>2</sup> This could produce a near doubling of current rates in Monterey -- rates that are already among the highest in California for investor-owned water utilities.<sup>3</sup> (The 2006 revenue requirement is in the range of \$32 million to \$34 million for the Monterey main system and will be determined by the Commission when it issues a final decision in Cal Am's general rate case proceeding (GRC), Application 05-02-012.) Under Cal Am's interim rate relief proposal, an average residential monthly bill will increase by \$23 to \$40 depending on which rate design proposal is adopted by the Commission in the same GRC. This means current residential monthly bills of \$31.65 would rise to either \$54.46, or \$69.45, by 2009 under Cal Am's surcharge proposals in this application. When and if the Coastal Water Project is placed into service, customer rates could jump another 30% beyond the 2009 rates.<sup>4</sup>

As discussed below, DRA opposes Cal Am's request to recover Coastal Water Project ("CWP") pre-construction costs before the Commission has even

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<sup>2</sup> Further Supplemental Direct Testimony of David P. Stephenson, October 14, 2005, page 7.

<sup>3</sup> Currently Monterey customers pay increasing block quantity rates. Rates that took effect on January 2006 for the average customer are a total of \$2.72 for the first block, \$4.36 for the second block, \$6.00 for the third block, \$7.63 for the fourth block, and \$14.18 for consumption over the fourth block allocation. The width of each block is a function of household size, lot size, and the number of large animals. An additional allotment is made for summer outdoor usage based on lot size. For example, a household of 3, on a ½ acre lot with no large animals would get 5 units (Ccfs) of water in each block in the summer. See also Section II.B.2. For customer billing purposes, a typical unit of water is 100 cubic feet, abbreviated as Ccf.

<sup>4</sup> Further Supplemental Direct Testimony of David P. Stephenson, October 14, 2005, page 8.

1 approved a Certificate of Public Convenience and Necessity ("CPCN") for this  
2 project. DRA recommends that the Commission condition any approval of Cal  
3 Am's request for recovery of preconstruction costs on the Commission's granting  
4 Cal Am a CPCN for the Coastal Water Project. Implementation of the  
5 preconstruction cost surcharge for approved expenditures described in Special  
6 Request #1 should be delayed until that time. Should the Commission not grant  
7 a CPCN to Cal Am for the Coastal Water Project, the Commission should  
8 reconsider the recovery of these preconstruction costs under the guidelines for  
9 recovery of costs for abandoned projects.

10 Likewise, as described further below, DRA recommends that any  
11 collection of revenues to offset the future costs of any long-term water supply  
12 solution for the Monterey Peninsula be deferred until construction on the Coastal  
13 Water Project or another alternative solution commences.

14 DRA is concerned with the frequency of rate increases in Monterey.  
15 Under Cal Am's interim rate proposal, ratepayers would be hit with rate  
16 increases every few months during the next 2 ½ years. This is unnecessary --  
17 especially when the actual construction and operation of the Coastal Water  
18 Project is still years away. The Monterey District ratepayers will be faced with a  
19 substantial rate increase sometime in the next few months, when the  
20 Commission issues a final decision in the Monterey General Rate Case for 2006.  
21 Under Cal Am's interim rate request for the Coastal Water Project, ratepayers  
22 would then see three additional increases in 2007, another three increases in 2008,  
23 and an increase in 2009 which would coincide with the effective date for the next  
24 GRC increase.

25 In summary, DRA makes the following recommendations. Details on  
26 each can be found in the report:

### 27 **Special Request 1**

- 28       ▪ The Commission should condition recovery of any approved  
29       2005 preconstruction costs on the granting of a CPCN for the  
30       Coastal Water Project and defer recovery until that time.
- 31       ▪ Any recovery of preconstruction costs the Commission  
32       authorizes prior to the Coastal Water Project being placed into  
33       service should be limited to 50% of approved costs.
- 34       ▪ The Commission should consider the reasonableness of 2006  
35       and 2007 preconstruction costs after they are incurred, in the  
36       next GRC.
- 37       ▪ 2006 and 2007 preconstruction costs should be reviewed and  
38       evaluated by an outside expert.

- \$1.2 million in 2005 public education and administrative costs should be disallowed.
- The Coastal Water Project memorandum account should earn interest at the 90 day commercial paper rate.
- Any surcharge authorized should be structured as a volumetric (per Ccf) surcharge on all units of water sold.

#### **Special Request 2**

- To prevent rate shock, Special Request 2 should only be authorized on a limited basis, with safeguards, and implemented once the Commission has approved a long term water supply project and construction has begun.
- The surcharge should be subject to reporting and renewal annually, starting with the next GRC.
- Funds raised should be tracked in a new customer contribution memorandum account solely for the purpose of offsetting future capital costs of any long term water supply solution.
- This memorandum account should earn interest at Cal Am's authorized rate of return.
- Plant funded by customer contribution should be permanently excluded from rate base.
- Plant funded by customer contribution should be subject to the same type of rules and procedures the Commission has established for government financed funding, such as grants and loans. In the event of a sale, ratepayers should not have to pay for plant they have contributed to again, nor should Cal Am gain from any such sale.

#### **Structure of any interim rate recovery surcharges**

- Any interim surcharges should be structured as a volumetric charge per unit of water, and not as a percentage of the customer bill since inequities in existing and proposed rate designs charge customers different amounts for the same water usage.

#### **Special Provisions for Low Income Customers**

- Customers enrolled in Cal Am's low income water rate assistance program, PAR, should pay half of any approved surcharges.
- Cal Am should enhance its outreach efforts to ensure all eligible customers are aware and enrolled in the PAR program by



1 sending out bill inserts twice a year in multiple language and  
2 enlisting local Community Based Organizations to help enroll  
3 eligible customers who may be unaware that this type of  
4 assistance is available.

- 5 ■ Cal Am's PAR program should be reviewed and evaluated in  
6 the next GRC.

7 DRA's recommendations as presented in this report are provisional, and  
8 apply to recommendations for interim rate relief only. DRA recommends the  
9 Commission consider not only final project cost but also recovery mechanisms in  
10 a subsequent phase of this application. Alternately, cost allocation issues could  
11 be considered in a subsequent separate application. This matter is too important  
12 and complex to be considered as part of a General Rate Case and should be  
13 considered in a separate application.  
14

## II. Overview

15 This report addresses Cal Am's request for interim rate relief in  
16 Application ("A.") 04-09-019 of California-American Water Company ("Cal  
17 Am") as modified in the most recent testimony.

### A. Background

18 Cal Am originally filed a motion for interim rate relief ("Motion")  
19 concurrently with an amendment ("Amendment") to its *Application for a*  
20 *Certificate of Public Convenience and Necessity to Construct and Operate Its Coastal*  
21 *Water Project to Resolve the Long-term Water Supply Deficit in its Monterey District*  
22 *and to Recover All Present and Future Costs in Connection Therewith in Rates, A. 04-*  
23 *09-019 ("Application"),* filed September 20, 2004. The motion and Amendment  
24 ("Amended Application") were filed July 14, 2005.  
25

26 In the Amendment and the Motion, Cal Am made four special requests for  
27 surcharges and a connection fee to recover costs associated with the Coastal  
28 Water Project. Those were<sup>5</sup>:

- 29 1. **Special Request #1:** *A \$5.25 per customer surcharge.* In this request, Cal  
30 Am sought recovery of all Coastal Water Project preconstruction

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<sup>5</sup> Cal Am Amended Application, July 14, 2005, Exhibit F; and concurrent Motion for Interim Rate Relief, including Special Requests for: (1) a surcharge for recovery of all preconstruction coastal Water Project costs; (2) a \$2.00 per unit high block surcharge; (3) a new service connection fee; and (4) a pre-completion surcharge.

expenditures<sup>6</sup> through the end of 2006. The proposed surcharge was to be a flat fee of \$5.25 per 5/8" meter equivalent from 2007 - 2013. Cal Am proposed to recover \$3,412,622 per year for a total of \$20,475,732 over the six-year period – an amount that includes interest at the 90-day commercial paper rate on the declining balance, with any remaining balance transferred to plant-in-service as part of the construction costs of the Coastal Water Project.

2. **Special Request #2: A \$2.00 Per Unit High Block Surcharge** Cal Am requested that a special \$2.00 per unit surcharge be added to the highest block rate for each customer class beginning January 1, 2007 and concluding on December 31, 2008 or when the project is complete and on line. Cal Am estimated the total amount to be recovered by the surcharge at \$1,041,516.
3. **Special Request #3: A New Service Connection Fee.** In this request, Cal Am sought authorization to immediately institute a connection fee of \$12,000 per acre-foot of water for all new connections. There was no estimate on the amount of revenues to be collected.
4. **Special Request #4: A \$2.20/Ccf Pre-Completion Surcharge.** Here Cal Am requested authority to implement a \$2.20 per unit surcharge when construction begins, then estimated as 2007, to be raised to \$3.83 per Ccf in 2008 to offset the ongoing carrying costs of the Coastal Water Project only, not any recovery of actual project costs. Rather than charge Allowance for Funds Used During Construction (AFUDC), Cal Am sought to recover the carrying costs on an annual basis.

An Administrative Law Judge ("ALJ") Ruling on September 6, 2005 directed Cal Am to submit further supplemental testimony on October 14, 2005. This ruling suggested that instead of collecting revenues to offset future construction costs of the Coastal Water Project, it would be more fruitful to consider collecting revenues to offset the cost of whatever water supply solution is ultimately approved. The ALJ Ruling suggested that Cal Am modify its request to an approach that would record collected revenues in an account specifically established to solve the State Water Resources Control Board (SWRCB) Order 95-10 situation. The ruling stated that such an approach would better reflect the uncertainty of whatever water supply solution would ultimately

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<sup>6</sup> Preconstruction costs include environmental studies, engineering, and the pilot project.

1 be approved, and requested Cal Am to address this approach in its October  
2 testimony.<sup>7</sup>

3 In response to this ruling, in its further supplemental direct testimony, Cal  
4 Am withdrew its previous Special Request #3 for a connection fee, and  
5 consolidated two of the other special requests (Special Request #2 and #4) into a  
6 single request for a simple percentage surcharge on all customer bills, starting at  
7 15%, then increasing by 15% per year until reaching 60%. Cal Am also proposed  
8 that revenues generated by the surcharge of the new Special Request #2 be used  
9 as contribution to offset the cost of a long-term Water supply solution as  
10 suggested by the ALJ.

11 On April 4, 2006 Cal Am filed additional further supplemental testimony  
12 updating and modifying its request to recover preconstruction expenditures in  
13 Special Request #1, as well as accelerating the implementation of percentage-of-  
14 the-bill surcharge requested in the new Special Request #2 in response to the  
15 elongation of the procedural schedule. On April 13, 2006 Cal Am filed corrected  
16 versions of the April 4, 2006 testimony.

17 Cal Am has stated that its goals in seeking interim rate relief are (1) to  
18 raise rates gradually to avoid rate shock that could be caused by a sudden  
19 increase in rates when construction of the Coastal Water Project (or other  
20 eventual long-term Water supply solution) is completed, (2) to have current  
21 ratepayers begin to pay for the replacement of water supplies they are using, and  
22 (3) to keep future rates lower by presently funding a portion of the project as  
23 contribution.<sup>8</sup>

## 24 **B. Data**

25 Cal Am filed a GRC (A.05-02-012) for test year 2006 on February 16, 2005.  
26 Neither a proposed nor a final Commission decision has been issued in this case.  
27 DRA and Cal Am entered into a partial settlement on a number of issues  
28 (Settlement), but several large items remain unresolved. In addition, there was  
29 no settlement on the new rate design for the Monterey District proposed by Cal  
30 Am in this GRC.

31 In the supporting exhibits to its interim rate request, Cal Am has provided  
32 monthly bill impacts for both the DRA and Cal Am numbers under the  
33 Settlement. Both sets of numbers include plant items that will be treated by  
34 Advice Letter in this GRC cycle. Taking into consideration the minimum (DRA)  
35 and maximum (Cal Am) expected rate increases the Commission may adopt,

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<sup>7</sup> Administrative Law Judge's Ruling Requiring Testimony regarding the Motion for Interim Rate Relief and Establishing a Schedule and Process for This Case, September 6, 2005, page 7.

<sup>8</sup> Further Supplemental Direct Testimony of David P. Stephenson, October 14, 2005, page 3.

1 ratepayers would expect to see rate increases in the range of 16.8% to 24.52%  
2 when the final decision in this GRC is issued in the next few months.

3 In addition, for each set of numbers, Cal Am provides monthly bill  
4 impacts under the current rate design and under the proposed rate design. DRA  
5 notes that the rate design comparisons by Cal Am and DRA in this report are for  
6 informational purposes only. Once the rate design is determined in A.05-02-012,  
7 then only information relating to the adopted design will be relevant here.

8 In essence, the uncertainty over the unresolved GRC leads to four possible  
9 scenarios for analysis. In analyzing Cal Am's interim rate relief proposal,  
10 Settlement rates with the adoption of DRA's recommendations on the contested  
11 issues provides a minimum level of impact under either rate design, while using  
12 Settlement rates and the adoption of Cal Am's recommendations on the  
13 contested issues provides a maximum, or outer limit, impact.<sup>9</sup> To simplify the  
14 number of possible scenarios, DRA uses the latter for analysis purposes to  
15 illustrate the maximum impact the CWP surcharge requests will have. DRA  
16 evaluates monthly bill impacts under both rate designs using these numbers. In  
17 addition, all examples in this report refer to monthly bills.

18 Because a final decision in the GRC is already months behind schedule,  
19 and Public Utilities Code Section 455.2 allows for interim rates to be adjusted  
20 upwards once final rates are issued, Cal Am ratepayers will not only receive a  
21 large rate increase when the final Commission GRC decision is issued, they will  
22 also be required to pay back revenues that were deferred since January 1, 2006 –  
23 the effective date of interim rates.<sup>10</sup> **Because the exact amount and amortization  
24 schedule is unknown at this time, neither this report, nor Cal Am's Exhibits  
25 take account of the fact that Monterey customers will have to pay an additional  
26 surcharge to true up interim rates back to January 1, 2006. DRA estimates the  
27 deferred revenues could be in the range of \$3 million to \$4 million.**

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<sup>9</sup> The contested issues are: 1) the ratemaking treatment of past, present and future costs related to the seismic retrofitting of the San Clemente Dam, 2) the recovery of the stranded costs related to the proposed Carmel River Dam and reservoir Project, 3) authorization to track Endangered Species Act fines, if levied, in a memorandum account, 4) authorization to track State Water Resources Control Board fines, if levied, for over pumping the Carmel River in a memorandum account, and 5) rate design.

<sup>10</sup> In an Ex Parte meeting with Commissioner Bohn's office on April 13, 2006, Cal Am discussed "the potential impact on customers of the delay of a final rate case decision. Cal-Am representatives explained that this could result in a first-year increase of ... up to 30 percent for Monterey District customers if the final decision is issued in July 2006." Cal Am Ex Parte Notice filed April 19, 2006. The 30% figure is based on adopting DRA's recommendations. If some or all of Cal Am's recommendations are adopted this figure would be higher.

1                               **1) Monthly residential bill impacts from proposed**  
2                               **interim rate relief surcharges.**

3               Table 1 below summarizes Cal Am estimates of monthly bill impacts on  
4 an average usage residential ratepayer using 7 Ccfs per month. (The table  
5 assumes a household of 3 on a 3/8 acre lot with no animals.) Bill impacts are  
6 shown under both current and proposed rate designs for comparison. This table  
7 does not include any surcharge for deferred revenues owed Cal Am because of  
8 the delay in the final GRC decision. This surcharge would be in addition to the  
9 numbers shown here.<sup>11</sup>

10              As can be seen from the table, a customer with a monthly bill of \$31.98  
11 today could expect their bill to more than double by January 2009, to \$69.45 per  
12 month for the same water usage. This would be a \$37.47 increase. If the  
13 Commission adopts Cal Am's proposed rate design in A.05-02-012, a customer  
14 with a monthly bill of \$31.98 today would see his or her bill increase somewhat  
15 less, to \$54.46 a month – a \$22.48 increase. Either way, average bills would go up  
16 by a total of 70% by January 2009 under Cal Am's interim rate relief proposal for  
17 the Coastal Water Project. Cal Am estimates at this time that if and when the  
18 Coastal Water Project is placed in service, an additional rate increase of  
19 approximately 30% will be needed to cover the annual revenue requirement of  
20 the project. This is not shown in the table below.

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<sup>11</sup> This surcharge could be in the range of 10% to 12% for the remainder of 2006, if the Commission decides to collect the total amount of deferred revenues in 2006 and a Commission decision were issued in July. See footnote 7.

1

Table 1

Cal Am's Interim Rate Proposal - Residential Bill Impacts*			
Bills for average household of 3 people, no animals, on a 3/8 acre lot.			
		Average Monthly Bill	
Date	Rate Increases**	<u>Present</u> Rate Design	Increase over current rates
Jun-06	<i>current bill</i>	\$31.98	
Fall-06	~GRC increase	\$37.52	\$5.54
Jan-07	~GRC increase + <b>4% + 15%</b>	<b>\$46.36</b>	<b>\$14.38</b>
Jul-07	<b>7% + 15%</b>	<b>\$47.54</b>	<b>\$15.56</b>
Sep-07	<b>7% + 30%</b>	<b>\$52.98</b>	<b>\$21.00</b>
Jan-08	~GRC increase	\$53.86	\$21.88
May-08	<b>7% + 45%</b>	<b>\$59.39</b>	<b>\$27.41</b>
Jul-08	<b>10% + 45%</b>	<b>\$60.60</b>	<b>\$28.62</b>
Jan-09	~GRC increase + <b>10% + 60%</b>	<b>\$69.45</b>	<b>\$37.47</b>
		<u>Proposed</u> Rate Design	
Jun-06	<i>current bill</i>	\$31.98	
Fall-06	~GRC increase	\$29.48	-\$2.50
Jan-07	~GRC increase + <b>4% + 15%</b>	<b>\$36.37</b>	<b>\$4.39</b>
Jul-07	<b>7% + 15%</b>	<b>\$37.30</b>	<b>\$5.32</b>
Sep-07	<b>7% + 30%</b>	<b>\$41.58</b>	<b>\$9.60</b>
Jan-08	~GRC increase	\$42.24	\$10.26
May-08	<b>7% + 45%</b>	<b>\$46.59</b>	<b>\$14.61</b>
Jul-08	<b>10% + 45%</b>	<b>\$47.52</b>	<b>\$15.54</b>
Jan-09	~GRC increase + <b>10% + 60%</b>	<b>\$54.46</b>	<b>\$22.48</b>
* Data from Cal Am Exhibit E, pg.1 April 13, 2006 Testimony of David P. Stephenson			
** Special Request #1: <b>4%, 7% &amp; 10%</b> in black bold. (Recovery of preconstruction costs. Special Request #2: <b>15%, 30%, 45% and 60%</b> . (Customer contribution to capital costs.)			

2

3

## 2) Cal Am existing and proposed Monterey residential rate designs.

4

5

As noted above, Cal Am proposed revisions to its current rate design in its most recent GRC, A.05-02-012. This was only one of the contested issues in the GRC, and a Commission decision is still pending.

6

7

8

Both existing and proposed residential rate designs have increasing block rates with five tiers. Both are considered 'per capita' rate designs because they are individually tailored to specific circumstances of each customer household.

9

1 Under the current rate design, a customer is allotted units in each tier  
2 based on household size, lot size and number of large animals, and there is an  
3 additional adjustment for lot size in the summer. Under the proposed rate  
4 design, the household size, lot size and number of animals determine the first  
5 tier allotment. The width of each subsequent block is based only on lot size and  
6 animals, and there is no additional summer adjustment.

7 As an example, a household of three, on a 3/8 acre lot with no large  
8 animals would get 5 Ccfs in each block under the current rate design; water  
9 usage over 20 Ccfs per month would be charged at the highest rate. Under the  
10 proposed rate design, that same household would get 7 Ccfs in the first block,  
11 but only 2 Ccfs in each subsequent block; water usage over 13 Ccfs per month  
12 would be charged the highest rate. This means that under the proposed rate  
13 design, bills for the average customer will go down for usage of 7 Ccfs since this  
14 usage is all charged in the first block, but usage in the fifth block (over 13 Ccfs in  
15 this example) would quickly result in higher bills than under the existing rate  
16 design.

### III. Evaluation

#### A. Issues

18 In evaluating whether to grant Cal Am interim rate requests, DRA  
19 identified the following issues and addressed many of them:

- 21 1. Should current ratepayers pay for the replacement of water supplies they  
22 are currently using?
- 23 2. Should Monterey District rates be raised gradually to avoid rate shock  
24 that could occur if none of the costs of the Coastal Water Project are  
25 included in rates until it is completed, and becomes used and useful?  
26 What is rate shock?
- 27 3. Should present customers be required to pay *now* for costs associated with  
28 plant additions that will not be in place for several years?
- 29 4. Will the two special requests keep ultimate project capital costs down,  
30 thus reducing rates to customers in the future? Do these proposals  
31 provide equity between present and future ratepayers?
- 32 5. Should Cal Am be authorized to recover reasonable preconstruction costs  
33 booked (or expected to be booked once incurred) to the memorandum  
34 account authorized in D.03-09-022? If so,

- 1           ○ What amount should be authorized for recovery? Are costs
- 2           reasonable? Should any costs be disallowed? Has Cal Am
- 3           demonstrated that its request for recovery of “public information
- 4           costs” serve a legitimate public education function? Or are these
- 5           costs more in the nature of advocacy? Have all lobbying costs been
- 6           removed from the request?
- 7           ○ If authorized, when should the cost recovery start? How many
- 8           years are needed to recover the approved costs?
- 9           ○ How should estimated preconstruction costs which have not yet
- 10          been incurred, and incurred preconstruction costs which have not
- 11          been audited or reviewed for reasonableness be treated?
- 12          ○ Should the interest rate on the authorized costs be the 90-day
- 13          commercial paper rate as it is now, or Cal Am’s authorized rate of
- 14          return?
- 15          6. Should Cal Am be authorized to charge ratepayers a surcharge to collect
- 16          funds to offset the costs of a long term water supply solution to meet the
- 17          mandates of State Water Resources Control Board (SWRCB) Order 95-10
- 18          *in advance* of a decision about a water supply solution *and before* any
- 19          construction costs are incurred?
- 20               ○ Are future rates kept lower by having customers fund a portion of
- 21               the Coastal Water Project (or alternate long term water supply
- 22               project) now?
- 23               ○ How much should ratepayers contribute, and why?
- 24               ○ How much, if at all, will any ratepayer contribution reduce future
- 25               rates?
- 26               ○ How will these dedicated funds be tracked? In what type of
- 27               account will the funds be held? Should tax benefits and interest
- 28               earned on the funds be credited to the contribution account?
- 29               ○ Should there be any special reporting requirements to ensure
- 30               transparency and accountability of this atypical fund?
- 31               ○ When and how will the purpose and allowable uses of the funds be
- 32               decided? What type of Commission authorization is necessary?
- 33               ○ Under what circumstances are the funds to be refunded to
- 34               ratepayers?
- 35          7. Surcharges



- 1           ○ How should authorized costs be allocated to ratepayers in an
- 2           equitable way? What type of surcharges should be authorized?
- 3           Will a surcharge based on percentage of the bill fairly spread the
- 4           costs of the Coastal Water Project to those who benefit from it?
- 5           ○ Should ratepayers of the Bishop, Ambler, Ryan Ranch, and Hidden
- 6           Hills subsystems be excluded from paying these surcharges as
- 7           proposed by Cal Am?
- 8           ○ What can be done to keep water affordable for basic uses as
- 9           required by Public Utilities Code Section 739.8(a)<sup>12</sup>?
- 10          ○ How will any surcharges affect residents of multi-family dwellings
- 11          that are master metered?
- 12          8. Are special provisions needed for customers enrolled in Cal Am's low
- 13          income ratepayer assistance program, PAR? If so, what? Or are changes
- 14          to the PAR program needed to ensure all eligible customers are aware of
- 15          it?

## 16                   **B. Cal Am Special Request 1**

17           In this special request, Cal Am requests recovery over an eight-year  
 18           period all preconstruction expenditures<sup>13</sup> for the Coastal Water Project that are  
 19           tracked in the memorandum account previously authorized by the Commission  
 20           (D.03-09-022 (2003), 1997 Cal. PUC LEXIS 1279, \*43.) Previously Cal Am  
 21           proposed recovery of these costs via a six-year surcharge of \$5.25 per month per  
 22           5/8" meter equivalent beginning January 1, 2007, with interest on the funds at the  
 23           previously approved 90 day commercial paper rate. Cal Am now proposes that it  
 24           be authorized to implement a three-phase surcharge over the next 8 years to  
 25           recover these costs which, with interest at Cal Am's authorized rate of return,  
 26           total \$28.8 million.

27           If authorized, the first phase would recover all approved costs through  
 28           December 31, 2005 (\$8,674,759). Phase 2 would recover preconstruction costs  
 29           estimated to be incurred in 2006 (\$5,048,000) and Phase 3 would recover those  
 30           costs estimated to be incurred 2007 (\$7,590,000). Cal Am proposes a staggered  
 31           start date for each of the three phases, with Phase 1 beginning on January 1, 2007,  
 32           Phase 2 on July 1, 2007 and Phase 3 on July 1, 2008; but proposes a uniform end  
 33           date, with all three phases concluding sometime during 2014.

---

<sup>12</sup> Public Utilities Code Section 739.8(a) states, "Access to an adequate supply of healthful water is a basic necessity of human life, and shall be made available to all residents of California at an affordable cost."

<sup>13</sup> Preconstruction costs include preliminary engineering studies, environmental studies, analysis of necessary permitting requirements, the pilot project, development of cost estimates for the CWP and public education and outreach.

**Table 2 <sup>14</sup>: Special Request 1 – Preconstruction Costs, Interest & Totals**

Phases	Costs	Interest*	Total
Phase 1	\$8,674,759	\$3,050,000	\$11,724,759
Phase 2	\$5,048,000	\$1,930,000	\$6,978,000
Phase 3	\$7,590,000	\$2,510,000	\$10,100,000
<b>Total</b>	<b>\$21,312,759</b>	<b>\$7,490,000</b>	<b>\$28,802,759</b>

\*Cal Am proposes interest on the declining balance at their authorized rate of return, estimated at 8.33%.

Cal Am requests that approved charges be allowed to accrue interest at Cal Am's current authorized rate of return for the Monterey District, estimated at 8.33% as set forth in the Settlement in A.05-02-012.<sup>15</sup> This is a change from what Cal Am requested in its Amended Application. There, Cal Am requested that interest on the approved charges be allowed at the 90 day commercial paper rate, calculated at 2% in the attached Exhibit F to that application.<sup>16</sup>

Cal Am proposes that the surcharge be a percentage of base water charges on all customer bills, growing from 4% in January 2007 to 10% in two years, and staying at 10% until approved preconstruction expenditures are fully recovered sometime in 2014.

**Table 3: Special Request 1 Three Phase Surcharge**

Phase	Preconstruction costs	Start date	End date	Incremental Surcharge	Cumulative Preconstruction Surcharge #1
Phase 1	Costs through 2005	Jan 1, 2007	2014	4%	<b>4%</b>
Phase 2	2006 costs	July 1, 2007	2014	3%	<b>7%</b>
Phase 3	2007 costs	July 1, 2008	2014	3%	<b>10%</b>

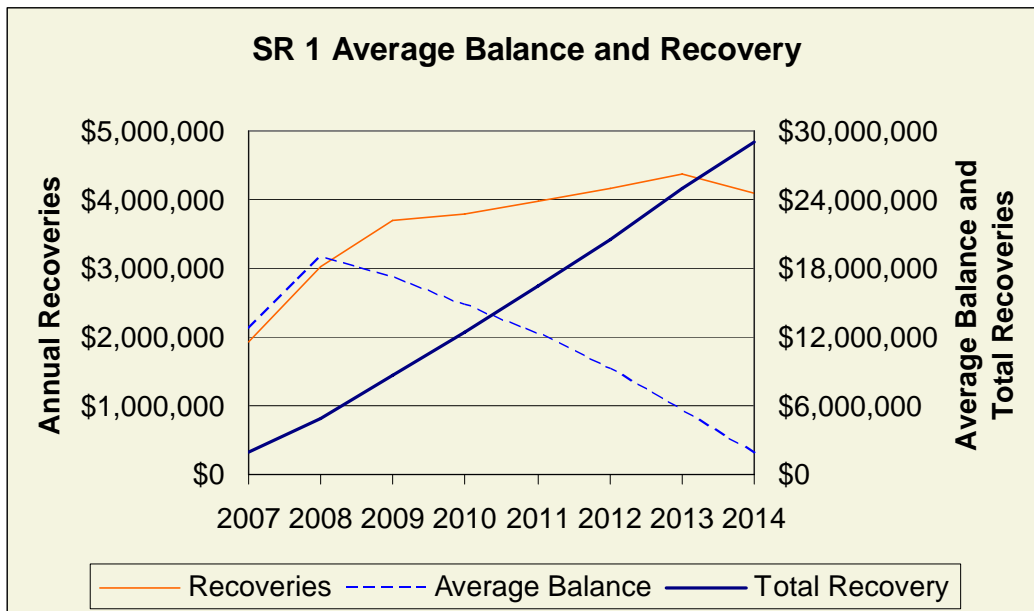
The following chart graphically illustrates the average balance and recovery of Cal Am's request.

<sup>14</sup> Cal Am, Additional Further Supplemental Direct Testimony of David P. Stephenson, Corrected, April 13, 2006, Exhibit C, page 1.

<sup>15</sup> Settlement agreement between Cal Am and DRA in A. 05-02-012. Final Commission decision still pending.

<sup>16</sup> Cal Am Amended Application, July 14, 2005, page 10 and Exhibit F.

Chart 1



Data from Stephenson, 4-13-06 Testimony, Exhibit C.

Cal Am states the purpose of Special Request #1 is to (1) keep the overall cost of the Coastal Water Project down, (2) to begin to raise rates gradually to avoid rate shock once the project comes online, and (3) apply some of the project charges to current customers who will benefit from this project.<sup>17</sup> Cal Am states that recovering the preconstruction costs now will lower the capitalized portion of the final Coastal Water Project, keeping overall revenue requirement down.<sup>18</sup>

**1) The Commission should condition recovery of any approved 2005 preconstruction costs on the granting of a CPCN for the Coastal Water Project and defer recovery until that time.**

In Special Request #1, Cal Am requests recovery for the preconstruction expenses it has been tracking in the previously authorized memorandum account. Because of the extremely high cost of the Coastal Water Project, Cal Am has proposed to expense preconstruction costs starting in 2007, in part to help keep ultimate project costs down and to mitigate potential rate shock that would otherwise occur when such an expensive project is placed into service.<sup>19</sup>

<sup>17</sup> Cal Am, Additional Further Supplemental Direct Testimony of David P. Stephenson, Corrected, April 13, 2006, page 3.

<sup>18</sup> Cal Am, Supplemental Direct Testimony of David P. Stephenson, July 14, 2005, page 10.

<sup>19</sup> Cal Am has noted that the additional revenue requirement once the Coastal Water Project is put into service could be an additional \$27 million to \$32 million per year. Further Supplemental Direct Testimony of David P. Stephenson, October 14, 2005, Page 7.

1 Cal Am argues that to avoid rate shock once the Coastal Water Project  
2 comes online, rates should begin to increase gradually starting in 2007. DRA  
3 agrees with the goal of mitigating potential rate shock but disagrees with how  
4 Cal Am proposes to do it. Circumstances have changed very little since D.03-09-  
5 022 was issued. In that decision the Commission denied Cal Am's proposal to  
6 allow pre-construction costs from the CWP project to earn Cal Am's authorized  
7 rate of return. D.03-09-022 (2003), 1997 Cal. PUC LEXIS 1279, \*33. The  
8 Commission stated:

9  
10 Because the Coastal Water Project will clearly require  
11 a significant period of time for construction,  
12 distinguishing it from typical water utility  
13 construction projects, we conclude that is not entitled  
14 to specialized CWIP ratemaking treatment offered to  
15 short duration water projects. In addition, the costs at  
16 issue here are predecessor costs to construction costs,  
17 in other words, construction work is not underway on  
18 the project and thus they are not funds used during  
19 construction. It remains unclear at this time when (or  
20 whether) any plant construction will commence.  
21 Therefore, allowing these preliminary costs to earn  
22 the utility's authorized rate of return now carries with  
23 it significant risk that the ratepayers may never  
24 receive the benefits of these expenditures.  
25

26 For these reasons, we conclude that the most  
27 appropriate manner to track these costs is for Cal-Am  
28 to establish a memorandum account to books costs  
29 associated with initial, preliminary engineering  
30 studies, environmental studies, analysis of necessary  
31 permitting requirements, and development of cost  
32 estimates for the Coastal Water Project. ... **As the**  
33 **status of the proposed project becomes more certain**  
34 **(for example, if a CPCN is granted or construction is**  
35 **underway), we will consider modifying this**  
36 **ratemaking treatment upon application by Cal-Am.**  
37 Id. at \*32-\*33 (emphasis added).

38 Cal Am is now seeking recovery of the pre-construction costs that have  
39 been tracked in the memorandum account (Special Request #1). Yet, the status of

1 the CWP project is still uncertain. A CPCN has not yet been granted, the pilot  
2 project is over a year late and is not scheduled to be up and running until  
3 October 2006.<sup>20</sup> Cal Am has not yet secured a project site<sup>21</sup>, and construction of  
4 the CWP, if approved, is still several years away. The ownership and governance  
5 of the proposed desalination plant are also still unclear. To DRA's knowledge,  
6 Cal Am has not complied with the requirement for a public agency partner as  
7 required by Monterey County Code Chapter 10.72, which mandates that  
8 desalination plants be publicly owned.

9 Even if the CWP or similar project is built, there is still significant  
10 uncertainty surrounding whether Cal Am will be the project sponsor. Cal Am  
11 shifted emphasis from a regional project to a project that only addresses the Cal  
12 Am's water supply needs. (A.04-09-019, Amended July 14, 2005, p. 3.) In its  
13 Amended Application, Cal Am states:

14 [I]t appears that the Monterey County agencies and  
15 the neighboring water districts interested in such a  
16 partnership will require more time than anticipated to  
17 reach a consensus on the issues of participation in,  
18 governance and financing of the larger regional  
19 facility. Because of the pressing need to develop a  
20 new water supply for California American Water's  
21 Monterey District, California American Water  
22 believes it is most prudent to proceed with the  
23 construction of the Proposed Project. (Id. at pp 3-4.)

24 DRA notes there are competing desalination project proposals on  
25 Monterey Bay, including a larger project proposed by Pajaro Sunny Mesa  
26 Community Services District in Moss Landing and a smaller project proposed by  
27 the Monterey Peninsula Water Management District ( MPWMD) in Sand City.<sup>22</sup>  
28 Pajaro Sunny Mesa has partnered with Poseidon Corporation and is proposing a  
29 20 million gallon per day (mgd) competing desalination plant on the former  
30 National Refractories site, across the street from Cal Am's preferred site at the  
31 Moss Landing Power Plant. The Sand City desalination plant previously  
32 proposed by MPWMD is a 7.5 mgd (or 8,409 AFY) plant. It was the subject of a

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<sup>20</sup> Cal Am response to DRA Data Request CWP 14-8.

<sup>21</sup> Cal Am response to DRA Data Request CWP 14-7. The situation is similar to the one a year ago, except that Duke Energy sold the Moss Landing Power Plant to LS Power in May 2006. Cal Am states they have been in contact with LS Power, and LS Power's policy is similar to Duke's in that they are willing to negotiate a lease agreement conditioned on Monterey County support of the desalination project and Cal Am's obtaining necessary permits, but that there is no agreement for the permanent use of the site at this time.

<sup>22</sup> See matrix compiled by MPWMD comparing these three desalination plants on the MPWMD website at <http://www.mpwmd.dst.ca.us/pae/matrix/matrix.htm> .

1 CEQA review by MPWMD. A Draft Environmental Impact Report was issued in  
2 December 2003 but never finalized by the Board.<sup>23</sup>

3 It appears very little has changed in the last year, and that there is still a  
4 “significant risk that the ratepayers may never receive the benefits of these  
5 expenditures.” (D.03-09-022, at page 32)

6 **DRA recommends that the Commission condition any approval of Cal**  
7 **Am’s request for recovery of preconstruction costs on the Commission’s**  
8 **granting Cal Am a CPCN for the Coastal Water Project. Implementation of the**  
9 **preconstruction cost surcharge for authorized expenditures described in**  
10 **Special Request #1 should not start until that time.** This is a reasonable  
11 compromise. It will help toward the goal of keeping the ultimate project cost as  
12 low as possible, and it will start to increase rates during construction, thus  
13 mitigating potential rate shock once the project is placed in service.

14 **2) Any recovery of preconstruction costs the**  
15 **Commission authorizes prior to the Coastal Water**  
16 **Project being placed into service should be limited**  
17 **to 50% of approved costs.**

18 As stated above, DRA is concerned about both the magnitude and the  
19 pace of the preconstruction costs incurred by Cal Am, especially given the  
20 uncertainties surrounding the ownership structure of the project. Cal Am is  
21 currently requesting recovery of \$28,802,759 -- \$21,312,759 in preconstruction  
22 costs and \$7,490,000 in interest on the declining balance at Cal Am’s authorized  
23 rate of return. This is up substantially from Cal Am’s earlier estimates in the  
24 GRC and Cal Am’s Amended Application last July.

25 In the GRC Application , Cal Am based its request for recovery of  
26 preconstruction costs on an estimate of \$15.2 million (A.05-02-012, Cal Am  
27 Workpapers, Special Requests, p. 5). In its Amended Application, filed July 2005,  
28 Cal Am estimated that preconstruction costs would exceed \$18.6 million prior to  
29 2007 (Testimony of David Stephenson, p. 9). Now Cal Am estimates these costs  
30 at \$21.3 million through the end of 2007. In addition, Cal Am now seeks a higher  
31 interest rate on these funds. Instead of the 90 day commercial paper rate it  
32 originally requested, Cal Am now requests interest at its authorized rate of  
33 return, estimated at 8.33%.

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23 In spite of not certifying the EIR, the project may still be viable. The MPWMD has hired a consulting firm to review all three of these proposed desalination plants.

1 The requested preconstruction costs are unprecedented for an investor  
2 owned water utility. Cal Am should not expect ratepayers to pick up the tab for  
3 its carte blanche spending on these costs.

4 DRA is also concerned with potential duplicative costs, all which could  
5 ultimately be borne by the same ratepayers. DRA notes that in addition to  
6 competing desalination projects, MPWMD is proceeding with a CEQA review of  
7 a 1,000 AF Aquifer Storage and Recovery Project in Seaside. MPWMD is funded  
8 by a surcharge of 8.325% on Cal Am customer bills. DRA is concerned that  
9 ratepayers may be paying preliminary costs for duplicative projects.

10 Finally, while Cal Am has decided to proceed with a project that  
11 addressed just Cal Am's water supply needs, the Commission and many other  
12 public entities have emphasized the importance of a regional solution to the  
13 water supply problems on the Monterey Peninsula.<sup>24</sup> Should the project finally  
14 permitted be a regional project, it would have twice the capacity, and these costs  
15 could be recovered over a much greater volume of water sales. The Commission  
16 should revisit the issue of what share of the preconstruction costs are  
17 appropriately passed on to Cal Am ratepayers if a regional solution is the one  
18 adopted. Non Cal Am customers who would benefit from a regional project  
19 should contribute a share of the preconstruction costs as well.

20 Authorizing reimbursement of approved preconstruction costs before a  
21 plant is placed in service is unprecedented in itself. *Authorizing full*  
22 *reimbursement of preconstruction costs before a plant is even permitted or approved is*  
23 *totally unwarranted.* To do so would improperly shift the risk of the project to the  
24 ratepayers and remove company incentives to complete the work in a timely  
25 fashion. Furthermore, if the project never comes to fruition, the Commission  
26 should reconsider the appropriateness of recovery of these costs in light of the  
27 guidelines for abandoned plant.

28 Therefore, DRA recommends that any recovery the Commission  
29 authorizes prior to the Coastal Water Project being placed into service, be limited  
30 to 50% of approved costs. If the desalination project that is ultimately built is a  
31 regional project, the Commission can then apportion the remainder of the costs  
32 in an equitable away over all of the water users.

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<sup>24</sup> D.03-09-022 directed Cal Am to "thoroughly explore opportunities for partnerships with other regional water supply entities as it prepares its PEA and to incorporate such partnerships into the project if appropriate."

1                                   **3) The Commission should consider the**  
2                                   **reasonableness of 2006 and 2007 preconstruction**  
3                                   **costs after they are incurred, in the next GRC.**

4           DRA is also opposed to authorizing the recovery of preconstruction costs  
5 that have not yet been incurred. Prior to the Commission approving any  
6 recovery of 2006 and 2007 costs, the costs should be audited and evaluated for  
7 reasonableness. DRA recommends that prior to granting any recovery for 2006  
8 and 2007 preconstruction costs, those costs should be audited and evaluated for  
9 reasonableness by an outside auditor with expertise in the subject matter.<sup>25</sup>

10           DRA recommends that recovery of Cal Am's 2006 with 2007  
11 preconstruction costs be considered for recovery in the next GRC, which will be  
12 filed in January 2008. It appears increasingly unlikely that the Commission will  
13 have completed its CEQA review and approved or denied Cal Am's request for a  
14 CPCN much before January 2008. If a CPCN is granted, Cal Am should be  
15 authorized to begin recovery of Commission approved 2005 preconstruction  
16 costs at that time. An audit and review of the 2006 and 2007 preconstruction costs  
17 can be consolidated with the GRC, and if recovery is authorized, it can be  
18 coordinated with the 2009 rate increases.

19           Should the Commission not grant a CPCN to Cal Am for the Coastal  
20 Water Project, or should the project not come to fruition for other reasons, the  
21 Commission should reconsider the recovery of these preconstruction costs under  
22 the guidelines for recovery of costs for abandoned projects in the GRC, or other  
23 application if necessary.

24           Recovery of 2006 and 2007 preconstruction costs from ratepayers at this  
25 stage is still inappropriate, and those costs should continue to be tracked in the  
26 previously authorized memorandum accounts.

27                                   **4) 2006 and 2007 preconstruction costs should be**  
28                                   **reviewed and evaluated by an outside expert.**

29           DRA has reviewed Cal Am's 2005 preconstruction costs to ensure correct  
30 accounting procedures were followed and that costs were properly recorded in  
31 the memorandum account. The DRA audit checked to make sure costs are  
32 recorded correctly. It ensured that there was proper accounting, reviewed  
33 selected contracts, checked the nature of services provided and made sure proper  
34 internal controls were in place. (See DRA Audit Report, 6/19/2006)

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<sup>25</sup> Such an audit contract should be issued and overseen by DRA, not Cal Am. This can be done through a reimbursable contract if authorized.



1 In addition, in this report DRA addressed the reasonableness of some of  
2 the costs. However, DRA does not have the specialized expertise to evaluate the  
3 reasonableness of the various engineering and environmental costs, so DRA was  
4 unable to reach any conclusions on whether those costs were necessary and  
5 reasonable. DRA is concerned that some of these studies may be duplicative of  
6 work currently or previously done by other entities, yet DRA does not have the  
7 knowledge needed to ascertain this. In light of the magnitude of the estimated  
8 preconstruction costs, the Commission should consider a more in depth review  
9 by an outside expert able to assess the reasonableness of such costs.

10 **5) \$1.2 million in 2005 public education, outreach**  
11 **and administrative costs should be disallowed.**

12 Cal Am is requesting recovery of \$1,135,028 in public outreach costs and  
13 \$983,077 in legal and administrative costs (\$756,524 for legal and \$226,553 for  
14 administrative). The administrative costs were incurred by Nossaman, Gunther,  
15 Knox, and Elliot (Nossaman), a lobbying firm retained to do project management  
16 with regard to raising public awareness of the CWP and addressing community  
17 concerns. While categorized as administrative, these costs can also appropriately  
18 be considered as public relations costs. When these administrative costs  
19 incurred by Nossaman are added to Cal Am's public outreach costs, the total is  
20 \$1.36 million, or nearly 16% of the requested recovery of preconstruction costs  
21 through 2005, for public relations type activities.

22 Cal Am has failed to prove that these costs are truly needed, and are for  
23 public education and not advocacy. Cal Am has explained what it did, but it has  
24 offered no convincing justification for the need for so much publicity for the  
25 Coastal Water Project.<sup>26</sup> The need is certainly questionable, since the Monterey  
26 Herald has consistently covered all aspects of the water supply situation in great  
27 detail over a number of years – including covering Cal Am responses to parties'  
28 data requests on the Coastal Water Project. DRA counted well over one hundred  
29 articles in the last year alone on Monterey water issues in the Herald.

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<sup>26</sup> Cal Am states that "community outreach is critical complement of any California American water project with its service areas. In this case, there have been no desalination plants of the size and scope the coastal Water Project constructed California. Other major water supply project, including desalination proposals, the failed to obtain the needed local community support. In addition, the plant will be located outside of the service area which it would benefit. Under these circumstances, it would've been foolish for California American water not increase the level of public outreach is normally undertakes. The company's motivation in embarking upon the type at level of community outreach that it has for this project is quite simple -- to ensure that all impacted communities would be fully educated about the Coastal Water Project and have the opportunity to be heard." Cal Am Exhibit E, Direct testimony of Kevin A. Tilden, July 14, 2005, page 3.

1 Further, Cal Am has admitted that the one thing customers care a lot  
2 about – having specific information on how proposed desalination costs will  
3 impact their water bill – it has deliberately **not** provided.<sup>27</sup>

4 In response to DRA’s inquiry, Cal Am explained it did not address rate  
5 impacts specifically because both the current and proposed rate designs preclude  
6 general comparisons, (even though this is exactly what Cal Am provided to the  
7 Commission in this application, and to the customers in the public notices.) In its

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<sup>27</sup> In response to a DRA data request FWF 1-7, Cal Am states:

California American Water's ("CAW") has communicated directly with the public on the rate impact of the Coastal Water Project ("CWP") in largely general terms. CAW and the media produced informational pieces and articles that stated that the CWP will cause rates to approximately double. Customers have been informed by notices in this proceeding (A04-09-019) and notices pertaining to the 2005 General Rate Case Application (A05-02-012) of the then current rate impacts of the projects - by customer class.

At this stage in the project, **our customer impact communication has remained non-specific** for the following reasons:

First, **the current rate design in Monterey precludes reasonable general comparisons.** The current rate design is tailored to each individual customer based on lot size, the number of individuals permanently residing at the premise and other factors. It is impossible to provide general comparisons that fit individual customers. Additionally, CAW has proposed a change in the rate design in its current general rate case application (A 05-02-012). If the Commission accepts this proposed rate design change - it will impact the recovery of cost related to the Coastal Water Project.

Second, there are many alternatives in which CAW can recover its embedded capital costs and ongoing expenses. There are many different financing alternatives. All of these options and alternatives will impact the revenue requirements. The variation in the revenue requirement may be significant. **Providing customer bill impacts with so many uncertainties existing would only lead to possibly confuse customers once the real impacts were known.**

Third, the application, as amended, notes that projected construction costs of the project will be different than as presented in the application. **This application was not intended to speak directly to the actual rate impacts – those conversations will take place at another time.** This application is seeking approval to construct the CWP to satisfy State Water Resource Control Board ("SWRCB") Order WR 95-10. **It is acknowledged in the application, that cost and recovery from customers will have to be addressed at a later time.**

Finally, we have been very aggressive in stating publicly that we can't lose focus on the fact that there is no alternative but to bring a new supply of water into the Monterey area and that the cost of whatever the new supply may be - will be expensive. This message has continuously been explained to the community. **CAW does not believe that it is fruitful to disseminate actual bill impact information until later in the project where better information is available.**

**We do not want confusing or misleading information provided to the customers.** Once the project is further in its process we will then have more specific information as to the bill impact on individual customers. [Emphasis added.]

1 public meetings and color briefing packets, Cal Am goes into great detail on the  
2 technicalities of the proposed plant and what the company has done to date. The  
3 briefing packet references the total costs of the CWP and the costs per acre foot of  
4 water, but not what those numbers mean to ratepayers with regard to water  
5 service affordability. Cal Am further states that there are so many uncertainties  
6 to the various CWP financing options, that customers would just be confused.  
7 However, failing to talk about rate impacts may also be misleading, result in  
8 confusion and even opposition when customers realize just how much they will  
9 have to pay for desalinated water. If Cal Am's intention is to garner community  
10 support for desalination, failing to assess customers' willingness to pay for  
11 desalinated water is a flawed approach.

12 Cal Am has not demonstrated why its public outreach campaign needed to be so  
13 expensive. The requested \$1.36 million is what is left after Cal Am removed the  
14 \$521,245 in advocacy costs!<sup>28</sup> Cal Am's expenditures on this effort are excessive  
15 relative to the size of the customer base it serves. There are approximately 38,000  
16 customers on Monterey main system. **This level of expenditure exceeds \$35 per**  
17 **customer for public education and outreach that provided no customer specific**  
18 **information!** Cal Am has done nothing to show that expenditures of this  
19 magnitude were needed or successful. DRA has found no evidence that Cal Am  
20 evaluated the success of the campaign or that Cal Am even defined what a  
21 successful campaign would be.<sup>29</sup>

22 In contrast, last fall Cal Am spent approximately \$300,000 to help defeat a  
23 ballot measure to study a possible public takeover of its Monterey water system.  
24 The Monterey Herald reported that Cal Am outspent supporters of the measure

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<sup>28</sup> Cal Am spent \$1.87 million on public education, outreach and administration of this program but removed \$521,245 from its request, and is now requesting recovery for \$1.35 million instead. (\$1.135,028 in public education and outreach + \$226,533 in administrative costs = 1,361,561) The administrative costs are included under the legal category, but are costs to manage the public outreach program according to Cal Am.

<sup>29</sup> In the Direct Testimony of Kevin Tilden, July 12, 2005, he claims that "The Coastal Water Project Public Outreach Program thus far has been an unqualified success and has reached a record number of individuals and interest groups on the Peninsula. More than 50 town hall meetings have been held as well as dozens of other meetings with community-based and nongovernmental organizations. It is impossible to quantify the value of these meetings, because it is impossible to predict what the results of not having the meetings would have been, however the company made a conscious decision to what our knowledge is the most comprehensive outreach project ever done on the Peninsula due to this size, scope the cost of the project." There is no discussion of what kind of community support this outreach project was trying to build and to what extent it has been successful. Success appears to be measured in terms of number of people reached; there is no measure of change in public feeling about desalination or any metrics that show increase community support for a large scale desalination plant in Moss Landing. Cal Am told DRA in response to DRA data request FWF 1-7 that average attendance at the townhall meetings that Mr. Tilden attended was 15 to 20 people.

1 by a 10 to 1 margin in the costliest campaign ever on the Monterey Peninsula.<sup>30</sup>  
2 Cal Am has failed to explain why it needed to spend over four times this amount  
3 on public education for its proposed desalination plant. The Commission has  
4 traditionally disallowed funding for public relations and advertising. DRA  
5 supports the need for public education and outreach on this major project since it  
6 will have a major impact on customer bills. However, Cal Am has not shown it  
7 addressed the key issue to ratepayers nor has it made a convincing case for the  
8 need for such an expensive campaign.

9 DRA recommends the Commission disallow public relations and  
10 associated administrative costs in excess of \$160,000. This equates to  
11 approximately \$4.25/customer for public outreach. **DRA recommends the**  
12 **Commission disallow the remaining \$1.2 million in preconstruction costs for**  
13 **administrative and public outreach for being excessive, unnecessary and**  
14 **unsupported.**

15 **6) The Coastal Water Project memorandum account**  
16 **should earn interest at the 90 day commercial paper**  
17 **rate.**

18 The Coastal Water Project memorandum account should earn interest at  
19 the 90 day commercial paper rate, as authorized in D.03-09-022. As noted earlier,  
20 in D.03-09-022 the Commission stated that since its still unclear when and  
21 whether any plant construction will commence, “allowing these preliminary  
22 costs to earn the utility’s authorized rate of return now carries with it significant  
23 risk that the ratepayers may never receive the benefits of these expenditures. ...  
24 As the status of the proposed project becomes more certain (for example, **if a**  
25 **CPCN is granted or construction is underway**), we will consider modifying this  
26 ratemaking treatment upon application by Cal Am.” (D.03-09-022, page 32 and  
27 33, emphasis added) At this time, a CPCN has not been granted, nor has  
28 construction begun, therefore it is premature for the Commission to consider  
29 modifying the adopted ratemaking treatment. In addition, it is the procedure the  
30 Commission has adopted in a ratemaking proceeding for water utility balancing  
31 and memorandum accounts to earn interest at the 90 day commercial paper  
32 rate.<sup>31</sup>

33 **7) Any surcharge authorized should be structured**  
34 **as a per Ccf surcharge on all units of water sold.**

35 DRA discusses its recommendation on surcharges in Section D below.

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<sup>30</sup> Monterey Herald, “Cal Am Campaign costliest”, February 13, 2006.

<sup>31</sup> D.94-06-033.

## C. Cal Am Special Request 2

In Special Request 2, Cal Am proposes an increasing surcharge implemented on all customer bills starting January 2007 to pre-collect funds that will be used as an offset against the future cost of the Coastal Water Project or other long term water supply project. Under Cal Am's proposal, the surcharge would start out at 15% in January 2007, rise to 30% in September 2007, 45% in May 2008 and top off at 60% in January 2009. It would remain at that level until the Coastal Water Project or other approved long-term water supply Project is completed, or until it could be reviewed as part of Cal Am's 2012 Monterey District General Rate Case which will be filed in January 2011.

**Table 4: Special Request #2 Surcharge Amounts**

<b>Special Request #2 Surcharge</b>	<b>Percentage of Bill</b>	<b>Average Monthly Residential Surcharge #2 Amount</b>
Jan-07	15%	\$4.27 to \$5.45
Sep-07	30%	\$8.55 to \$11.08
May-08	45%	\$13.03 to \$16.61
Jan-09	<b>60%</b>	\$18.24 to \$23.36

Data from Cal Am Exhibit B, Additional Further Supplemental Direct Testimony of David P. Stephenson, Corrected, April 13, 2006.

Under the proposal, this surcharge would be on base water charges only, and would exclude the cost of other surcharges.<sup>32</sup> It would apply only to customers who received any portion of their delivered water from the Carmel River system.<sup>33</sup> Cal Am estimates that it would raise a little over \$22 million in the first two years, and if it continued into 2009 and beyond with a 60% surcharge, it would raise an estimated \$20 million annually.

<sup>32</sup> Cal Am, Additional Further Supplemental Direct Testimony of David P. Stephenson, Corrected, April 13, 2006, page 9.

<sup>33</sup> Under Cal Am's proposal, the surcharge would not apply to the subsystems of Bishop, Ambler, Ryan Ranch, Hidden Hills, Ralph Lane or Chualar.

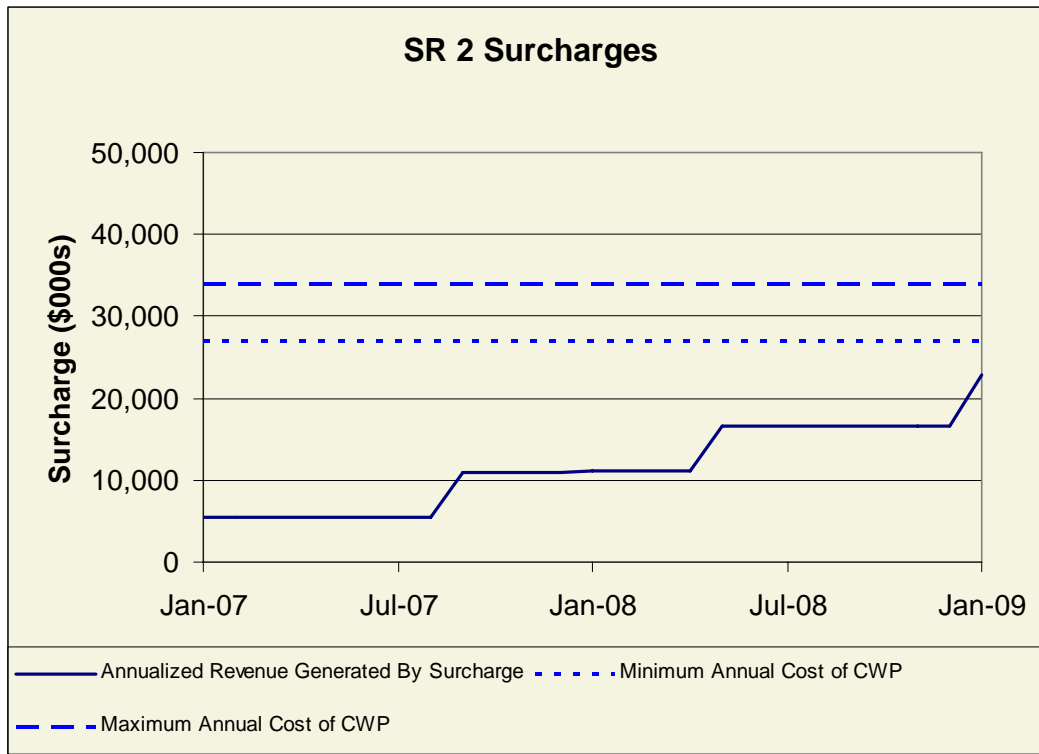
**Table 5: Special Request #2 – Surcharge Revenues**

Year	Revenues Generated
2007	\$7,272,500
2008	\$14,775,100
2009	~ \$23 million

Data from Cal Am Exhibit A, Additional Further Supplemental Direct Testimony of David P. Stephenson, Corrected, April 13, 2006.

The following chart graphically illustrates the average balance for Cal Am's Special Request #2.

**Chart 2: Special Request # 2 Revenues**



Cal Am proposes that "the revenues generated by this surcharge be used as contribution to offset the costs of the long-term water supply solution to address the constraints imposed by SWRCB Order 95-10 and the Endangered Species Act, whether it is the Coastal Water Project or an alternative project."<sup>34</sup> While this is consistent with what ALJ Cooke suggested in the Ruling on

<sup>34</sup> Cal Am, Further Supplemental Direct Testimony of David P. Stephenson, October 14, 2005, page 5.

1 September 6, 2005, it goes far beyond what the ALJ suggested in that it includes  
2 Endangered Species Act (ESA) constraints while the ALJ's suggestion did not.

3 Although Cal Am has proposed to record the revenues collected from  
4 Special Request 2-4 as contributions to offset construction costs, I suggest  
5 that is more fruitful for us to consider any collected revenues as revenues  
6 collected to offset the cost of whatever water supply solution is ultimately  
7 approved. For example, instead of recording the revenues specifically as  
8 contribution to offset construction costs, Cal Am should consider  
9 modifying its approach to record the collected revenues into an account  
10 specifically established to solve the SWRCB (State Water Resources  
11 Control Board) Order 95-10 situation. Such an approach will better reflect  
12 the uncertainty of what water supply solution will ultimately be  
13 approved.<sup>35</sup>

14 Previously Cal Am proposed the three other surcharges – a \$2 per unit  
15 surcharge to the highest block rate for each customer class, a new service  
16 connection fee, and a per unit surcharge on all water usage to offset the ongoing  
17 carrying costs of the Coastal Water Project. Cal Am states that its current  
18 simplified proposal is easier for Monterey District customers, parties and the  
19 Commission to understand and analyze. These proposals have all been dropped  
20 and were replaced with the current Special Request #2 surcharge.

21 Cal Am argues for this Special Request citing looming rate shock and the  
22 imperative to mitigate it whenever possible by raising rates gradually. Cal Am  
23 witness Stephenson states that in developing the proposed surcharge, Cal Am  
24 took into account the expected rate impacts of a new water supply. He estimated  
25 these costs at \$27 to \$32 million annually, but acknowledges that “these are  
26 estimates based on general assumptions and may bear no relationship to what  
27 may finally occur in the cost evolution to bring new water into Monterey.”<sup>36</sup> The  
28 estimates were made to show the level of surcharge needed to produce a fairly  
29 smooth step-up in rates so as not to cause rate shock.

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<sup>35</sup> Administrative Law Judge's Ruling Requiring Testimony regarding the Motion for Interim Rate Relief and Establishing a Schedule and Process for This Case, September 6, 2005, page 6.

<sup>36</sup> Cal Am, Further Supplemental Direct Testimony of David P. Stephenson, October 14, 2005, page 7.

1                   **1) Special Request 2 deviates from traditional**  
2                   **ratemaking by asking customers to pay for a long**  
3                   **term water supply project before it has been**  
4                   **approved or constructed.**

5           This Special Request offers an unprecedented compensation scheme. It  
6 deviates from traditional ratemaking, which requires the cost of utility plant to  
7 be found reasonable, and to have been placed into service prior to recovering the  
8 cost of plant in rates. In Special Request #2, Cal Am is asking ratepayers to  
9 essentially “prepay” for utility plant that is not used and useful, is not yet in  
10 service. Furthermore, construction on the proposed plant has not yet begun, nor  
11 has the proposed plant been permitted or approved by the Commission. In fact,  
12 even though Cal Am is proposing a Coastal Water Project as the long term water  
13 supply solution for the Monterey Peninsula, as stated above the final approved  
14 project may be something else – a regional desalination plant or purchase of  
15 desalinated water from a publicly owned and operated plant. Pre-collecting  
16 revenues to offset this plant runs completely counter to traditional ratemaking  
17 principles.

18           Cal Am has suggested that not only would this pre-collection address rate  
19 shock concerns by gradually increasing rates, but that it would also help keep  
20 future rates lower by presently funding a portion of the project as contribution.  
21 However, Cal Am does not provide any testimony on how much ratepayers  
22 would save under this type of prepayment arrangement.

23           This proposal provides a primary benefit to Cal Am in perhaps  
24 minimizing the extremely negative publicity that would surround a sudden one  
25 time increase in rates when and if the Coastal Water Project is placed into service.  
26 However, Cal Am fails to provide any evidence that ratepayers would be paying  
27 less as a result of this surcharge.

28           In essence, Cal Am is using ratepayer capital instead of shareholder funds  
29 to finance part of the utility plant. This special request benefits Cal Am.  
30 Ratepayers will still be paying high rates for a replacement water supply once  
31 construction on the Coastal Water Project or another project is completed.  
32 **Ratepayers should not be funding utility plant in any manner, traditional or**  
33 **otherwise, in advance of the Commission even deciding what it is that they**  
34 **will be funding.**



**2) To prevent rate shock, Special Request 2 should only be authorized on a limited basis, with proper safeguards, and implemented once the Commission has approved a long term water supply project and construction has begun.**

That said, DRA does find merit in the argument to gradually step-up rates to avoid eventual rate shock. DRA recommends the Commission consider this approach on a *provisional basis* if proper safeguards are in place once a long term water supply solution project has been approved by the Commission and construction has begun. Specifically, DRA recommends the following safeguards:

- Any collection of revenues to offset the future costs of any long-term water supply solution be deferred until construction on the Coastal Water Project or another alternative solution commences.
- The surcharge should be set so as to raise an amount equivalent to 10% of the authorized revenue requirement for one year. (See Section D below for DRA's surcharge recommendations.)
- The surcharge should be subject to reporting and renewal annually.
- Cal Am should seek renewal of this request, if warranted, in the next GRC scheduled to be filed in January 2008. At that time, Cal Am should report on CWP progress and provide justification for continuing or increasing this customer contribution surcharge.
- In the years between GRCs, Cal Am should file an Advice Letter, if warranted, to report on CWP progress and provide justification for continuing or increasing this customer contribution surcharge.
- Funds should be booked to a new memorandum account solely for the purpose of offsetting the future capital costs of any long-term water supply solution. The new memorandum account should be called "SWRCB Order 95-10 Water Supply Customer Contribution Memorandum Account."
- The SWRCB Order 95-10 Water Supply Customer Contribution Memorandum Account should earn interest at Cal Am's authorized rate of return since customers are in essence prepaying for plant.
- Use of funds in this account should be limited to offsetting the future capital costs of any long term water supply solution that is ultimately approved, or be refunded to ratepayers if something changes and a new plant is no longer necessary. Funds should not

1 be used for Endangered Species Act (ESA) compliance costs or  
2 fines.

- 3 □ Once the CWP, or other long term water supply project, becomes  
4 used and useful, Cal Am should seek Commission authority to  
5 disburse or transfer funds to a new customer contribution account  
6 in utility plant to offset approved plant charges for the CWP or  
7 other long term water supply solution. That account should be  
8 labeled “SWRCB 95-10 Customer Contribution”.
- 9 □ This contributed plant should be permanently excluded from rate  
10 base.
- 11 □ Customer contribution to utility plant should be subject to the same  
12 type of rules and procedures the Commission has established to  
13 preserve the public interest integrity of government financed  
14 funding, such as grants and loans.<sup>37</sup> Ratepayers should not have to  
15 pay for plant they have contributed to twice, nor should the  
16 company get any profit from the sale of such plant. Specifically,  
17 DRA recommends:
  - 18 ○ If the water supply project is sold to a private non-regulated  
19 company, Cal Am should return to ratepayers a pro rata  
20 share of the fair market value of the project.
  - 21 ○ If the water supply project is sold to a public entity, Cal Am  
22 will not seek any compensation for the fair market value of  
23 the pro rata share of the plant contributed by the  
24 customers.<sup>38</sup>
  - 25 ○ If the entire Monterey District water system is sold to an  
26 investor owned water utility, Cal Am will not seek any  
27 compensation for the fair market value of the pro rata share  
28 of the plant contributed by the customers and it will be  
29 retained on the books as customer contribution by the  
30 purchasing utility.
  - 31 ○ If the entire Monterey District water system is sold to a  
32 public entity, Cal Am will not seek any compensation for the  
33 fair market value of the pro rata share of the plant  
34 contributed by the customers.

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<sup>37</sup> See D.06-03-015.

<sup>38</sup> See Resolution F-632 which prohibits a utility from seeking any compensation for a plant financed by customers should that plant be acquired by a public entity.

## **D. Surcharges**

### **1) Any interim surcharges should be structured as a volumetric charge per unit of water, and not a percentage of the customer bill.**

DRA has carefully analyzed various options for structuring a surcharge to provide interim rate relief. In evaluating these options, DRA considered which surcharge structure would provide the most equitable distribution of costs. DRA focused primarily on the comparative merits of a percentage of the bill surcharge versus a per Ccf surcharge, along with various modifications to each that would give customers a certain quantity of water surcharge free, such as their tier one usage or one Ccf per person.

DRA's goal was to balance administrative simplicity with a fair allocation of costs to those whose water usage causes the need for the replacement water supply. DRA concluded that the percentage-of-the-bill surcharge mechanism as proposed by Cal Am offered great administrative simplicity but some inequities, and a per Ccf charge also offered administrative simplicity, and equity in other regards. After considering the pros and cons of the various options, DRA provisionally recommends the interim rate relief surcharges be structured as a volumetric surcharge on each unit (Ccf) of water used., DRA recommends this because of the inequities in both the existing and proposed Monterey rate designs which causes DRA to conclude that a per Ccf charge is fair to everyone and easy to understand.

### **2) Inequities in existing and proposed rate designs charge customers different amounts for the same water usage.**

Cal Am states the new proposal in revised Special Request 2 would distribute the cost of the Coastal Water Project equitably over all customer classes and all levels since high use customers already pay higher rates for water under Cal Am's conservation base rates, such customers would contribute a proportionally higher amount equal to the Coastal Water Project costs because the surcharge is based on a percentage of the bill.<sup>39</sup>

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<sup>39</sup> Cal Am, Further Supplemental Direct Testimony of David P. Stephenson, October 14, 2005, page 5.

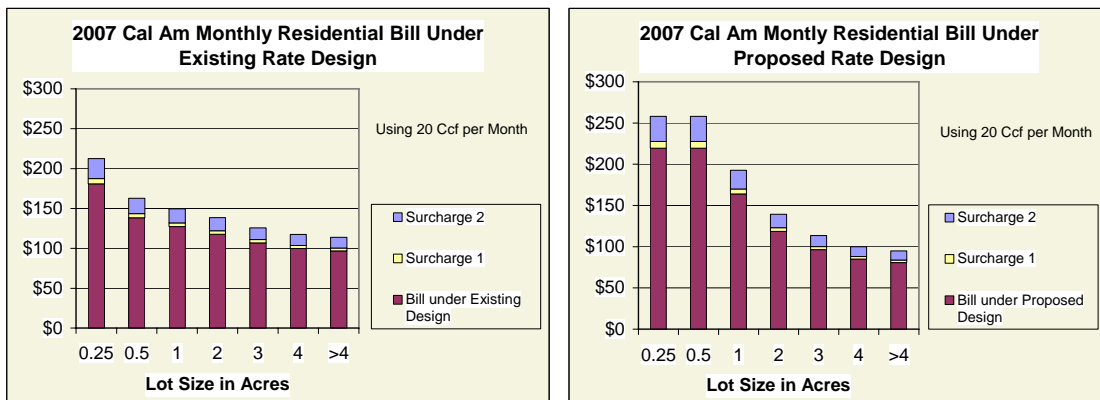
However, in analyzing both the current and proposed rate designs in Monterey, DRA found that both rate designs give discounts to customers with larger lots. DRA understands the rationale for this was to provide an allocation of water for landscape irrigation, yet the net effect of this is that customers using the same quantity of water get charged widely varying rates as shown in Table 6 and charts below for both the current and proposed rate designs.

**Table 6**

Bill Comparisons by Lot Size for 2007 Rates		
Monthly bill for household of 3, using 20 units with no large animals in the summer.		
Lot Size (Acres)	Existing Rate Design	Proposed Rate Design
0.25	\$180.83	\$219.47
0.5	138.44	219.47
1	127.16	163.91
2	117.82	118.55
3	106.93	96.63
4	99.93	84.90
>4	96.82	80.83

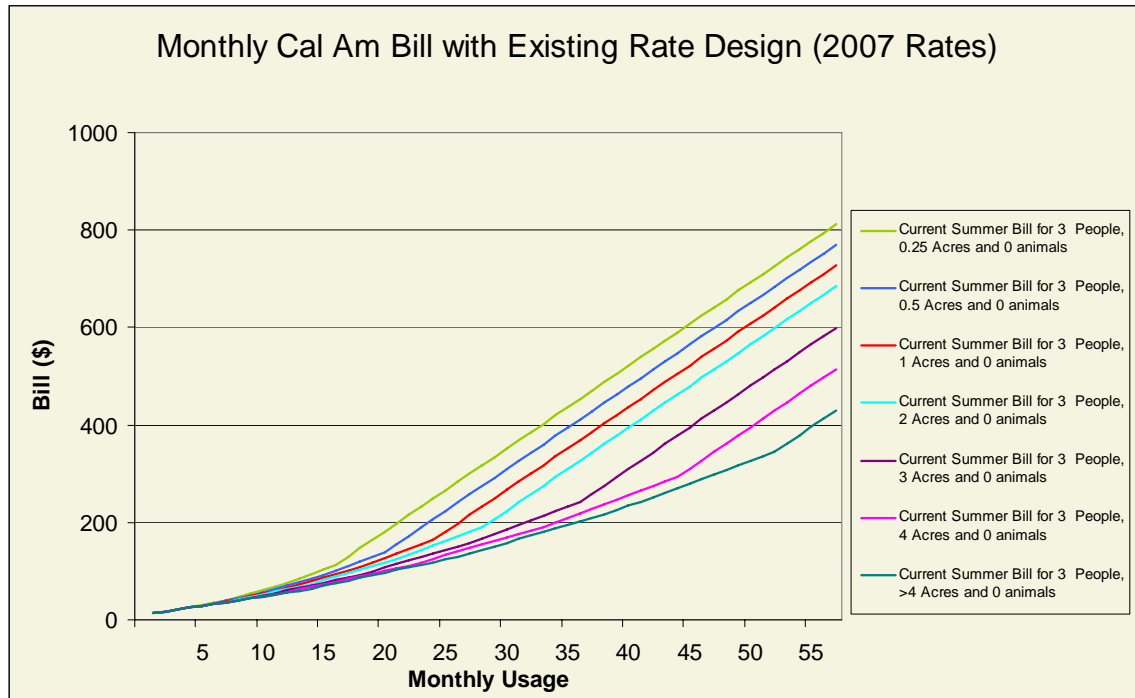
Chart 3 shows the impact on Cal Am's proposed surcharges for customers on varying lot sizes using 20 Ccfs of water. (Both charts assume no large animals, which is a factor in determining the allotted units under both rate designs.) As demonstrated in the charts, customers on small lots are paying in the range of two to three times as much for water as those on large lots for the same amount of water. A surcharge that is a percentage of the bill will carry forward that inequity.

**Chart 3: Monthly bill comparison for usage of 20 Ccfs on different sized lots**



Charts 4 and 5 further illustrate the inequity. For larger water users, the cheapest price for water is for those with the larger lots. Both the existing and the proposed rate designs provide this discount for those with larger lots (1 acre or more). However, the proposed rate design provides an even greater differential in price between those on small lots and large lots.

1 **Chart 4**

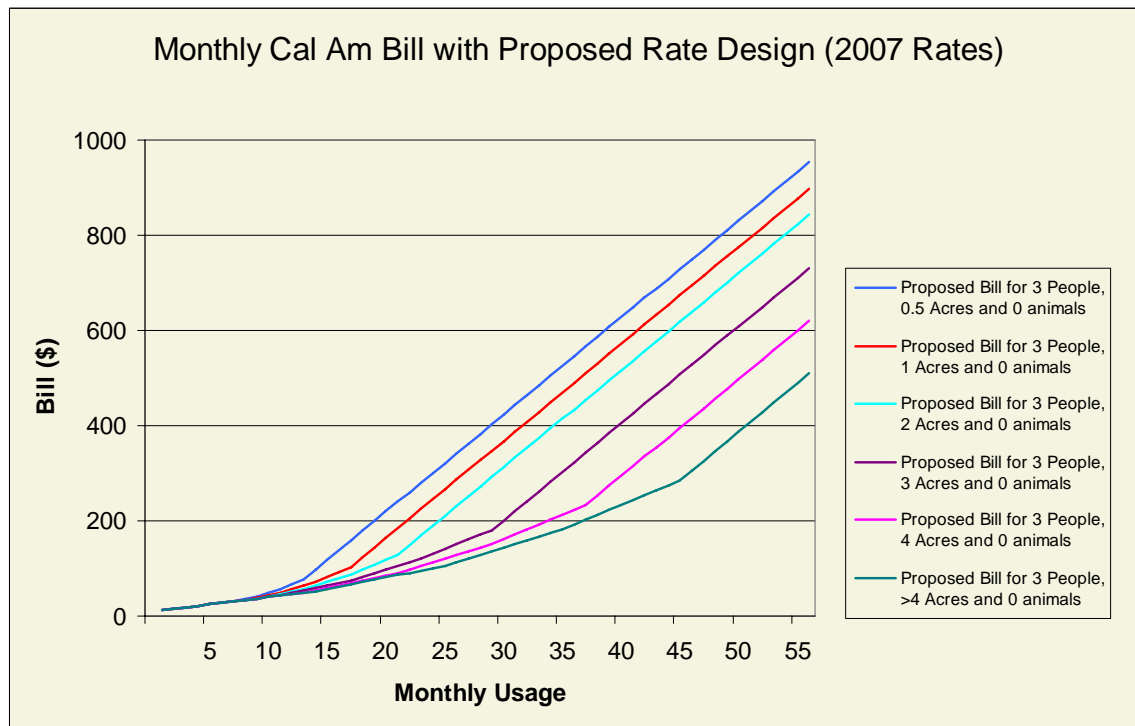


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3

4 **Chart 5**

5



6

7

1 In addition to the inequities for customers on different size lots, Cal Am  
2 provided data in their Amended Application which shows that multifamily  
3 residential customers and PAR customers use more water in the higher rate  
4 blocks.<sup>40</sup> If the surcharge is structured as a percentage-of-the-bill, these  
5 customers will pay higher surcharges for the same usage than other residential  
6 customers. DRA has some concern that the landlords may pass the surcharges  
7 through to tenants in rents. To the extent this occurs, customers who live in  
8 multi-residential units may shoulder a greater burden than other residential  
9 customers.

10 Because of these various inequities, DRA's concludes that a volumetric  
11 charge for each unit of water used would be more equitable. While low usage  
12 customers will pay somewhat more under a per Ccf surcharge, the mechanism is  
13 fair. It has the advantage of removing the inequities in the current and proposed  
14 rate designs that favor those with larger lots. It leaves the issue of providing a  
15 conservation signal to customers to the underlying rate design, while offering a  
16 straight forward, fair and easy to understand surcharge mechanism to provide  
17 for approved interim rate relief.

18 It makes the surcharge independent of which rate design the Commission  
19 adopts from the GRC. Customers will pay a higher total surcharge in  
20 proportion to their usage. It will be the same surcharge under either rate design.  
21 Everyone who uses a given quantity of water will pay the same surcharge,  
22 regardless of whether they live on a large or small lot.

23 A per Ccf surcharge will also be more equitable to PAR customers and  
24 multifamily residential units where Cal Am's data shows a greater percentage of  
25 usage in the upper blocks. (See sections below for further explanation.)

26 Table 7 below illustrates the monthly bill impacts for residential  
27 customers using 7, 12 and 25 Ccfs of water on various lot sizes under current rate  
28 design for each \$1 million in revenues raised per year. Table 8 illustrates the  
29 same but under the proposed rate design.

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<sup>40</sup> Amended Application, Supplemental Direct Testimony of David P. Stephenson, July 14, 2005, Exhibit G. See also Table 9.

1

Table 7

Surcharge Comparisons under Existing Rate Design (2007)				
Volumetric vs. 4% Surcharge Comparison				
	Usage (ccf)			
	<u>7</u>	<u>12</u>	<u>25</u>	
<b><u>Total Surcharge @\$0.24/Ccf</u></b>	\$1.68	\$2.88	\$6.00	
<b><u>Total Surcharge at 4% of Bill</u></b>				
	<u>Lot Size</u>			
	0.25	\$1.51	\$2.79	\$9.82
	0.5	1.45	2.59	8.26
	1	1.40	2.39	6.69
	2	1.34	2.33	5.99
	3	1.34	2.22	5.30
	4	1.34	2.10	4.90
	>4	1.34	2.04	4.57
(3 People, 0 Animals, Summer)				

2

3

Table 8

Surcharge Comparisons under Proposed Rate Design (2007)				
Volumetric vs. 4% Surcharge Comparison				
	Usage (ccf)			
	<u>7</u>	<u>12</u>	<u>25</u>	
<b><u>Total Surcharge @\$0.24/Ccf</u></b>	\$1.68	\$2.88	\$6.00	
<b><u>Total Surcharge at 4% of Bill</u></b>				
	<u>Lot Size</u>			
	0.25	\$1.14	\$2.46	\$11.87
	0.5	1.14	2.46	11.87
	1	1.14	2.10	9.82
	2	1.14	1.93	7.77
	3	1.14	1.78	5.17
	4	1.14	1.70	4.45
	>4	1.14	1.70	3.93
(3 People, 0 Animals)				

4

5 As can be seen from the tables above, a per Ccf surcharge is fair to all  
6 customers. Those who use more water will pay a higher surcharge no matter  
7 what size lot they have. DRA recommends the Commission adopt a volumetric  
8 surcharge on each unit of water used for use with any rate recovery authorized  
9 in this proceeding.

1 If the Commission authorizes recovery of revenues under Special Request  
2 #1 and/or Special Request #2, Cal Am should file an Advice Letter with surcharge  
3 amounts and required changes to the tariff sheets prior to implementing the  
4 surcharges.

5 **E. PAR customers should pay half of any approved**  
6 **surcharges at this time.**

7 DRA is concerned that the costs of the Coastal Water Project may result in  
8 an undue economic burden on Monterey District low income customers.  
9 Affordability is a real concern for many water utility customers. Many  
10 households face tough choices and real economic hardship. As mentioned  
11 earlier, Cal Am's Monterey District has some of the highest water rates in  
12 California. As Monterey rates increase even further, the burden on Monterey  
13 District fixed and low income ratepayers will grow.

14 Cal Am has analyzed the impact of the proposed surcharges on customer  
15 bills, including customers on its low income water rate assistance program,  
16 known as the PAR program. Cal Am showed bill impacts for average PAR  
17 customer based on usage of 5 Ccfs per month. Cal Am states that since PAR  
18 customers do not pay the monthly service charge, but only the monthly quantity  
19 charge, PAR customer bills are already discounted if the surcharge is based on a  
20 percentage of this discounted total bill. Cal Am states that because of this PAR  
21 customer contribution to the costs of the Coastal Water Project (or other eventual  
22 long-term water supply solution) would be proportionately lower.<sup>41</sup>

23 Cal Am's projected meter charge for 2007 is \$8.74. The surcharge savings  
24 PAR customers would see as a result of this discounted bill would be a  
25 maximum of \$2.67/month in 2007.<sup>42</sup> Exhibit E to Stephenson's April 13, 2006  
26 testimony shows the average surcharge for PAR customers by September 2007  
27 would be \$8.59 to \$10.16 per month, depending on which rate design is  
28 adopted.<sup>43</sup> While slightly less than other residential customers, this is still  
29 burdensome to those on fixed or low incomes and virtually wipes out the  
30 benefits obtained under the PAR program.

31 However, Cal Am has also provided data that show that PAR customer  
32 usage differs substantially from other residential usage in that 65% of PAR  
33 customer usage is in the upper rate blocks (tiers 2 – 5) whereas single family

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<sup>41</sup> Cal Am, Additional Further Supplemental Direct Testimony of David P. Stephenson, Corrected, April 13, 2006, page 10.

<sup>42</sup> The average surcharge amount PAR customers avoid is the average of \$8.74 times a surcharge of 19% (Jan – June), 22% (July – Aug ) and 37% (Sept – Dec) or \$2.67 in 2007.

<sup>43</sup> Ibid, Exhibit E.



1 residential customers only have 24% of their combined usage in these upper rate  
2 blocks.<sup>44</sup>

3 Table 9: Percentage Customer Usage in Lower and Upper Rate Blocks

	Block 1	Blocks 2 - 5
Residential	76%	24%
PAR	35%	65%
Multi-Residential	53%	47%

4 Percentages calculated from data provided in Supplemental Direct Testimony of  
5 David P. Stephenson, July 14, 2005, Exhibit G.

6 Since blocks 2 – 5 are more expensive, customers pay a greater surcharge  
7 for water usage in these blocks, since those tiers have higher rates. So in spite of  
8 the average usage for PAR customers being lower than non-PAR residential  
9 customers at 5 Ccfs/month, the actual bill impacts of CWP surcharges could be  
10 burdensome on PAR customers who use water in the upper tiers if the  
11 Commission adopts a percentage-of-the-bill type surcharge. And, under Cal  
12 Am's proposed rate design, this will be exacerbated since residential customers  
13 who currently get an allocation for the number of residents per household in the  
14 higher blocks, will no longer get that allocation. Therefore, if this rate design is  
15 adopted, water usage will fall within the higher tiers sooner than under the  
16 existing design.<sup>45</sup>

17 To avoid possibly severely impacting PAR customers who use greater  
18 quantities of water, DRA recommends the Commission adopt a per Ccf  
19 surcharge as described above. In addition, DRA recommends that the interim  
20 rate relief surcharges under Special Request #1 and Special Request #2 be  
21 discounted for PAR customers. **DRA recommends that PAR customers pay half**  
22 **of the regular interim rate surcharges charged to other customers.** PAR  
23 customer revenues are projected at 5% of total revenues for 2007. Estimated  
24 surcharge revenues from PAR customers make up less than 1% of the total  
25 surcharge revenues and would result in only a small increase for the rest of the  
26 customers.

27 DRA is also concerned about the impacts on fixed and low income  
28 households in the Monterey District who are not direct customers of Cal Am, but  
29 instead may live in apartments or trailer parks and are served water by a master-  
30 meter customer. There are still legal issues with extending the PAR program to  
31 sub-metered tenants and many apartment dwellers probably are not even sub-

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<sup>44</sup> DRA discussed this data with David Stephenson from Cal Am. He agreed with DRA that this data seemed questionable, but did not have an explanation for why the data showed this type of usage of PAR and multifamily customers.

<sup>45</sup> The breakeven point, where the proposed rate design becomes more expensive than the existing rate design for the average customer with a household of 3 on a half acre lot, is 14 units.

1 metered for water usage, but rather have the price of water incorporated into  
2 their rent. DRA is working with the utilities on finding a way to include sub-  
3 metered water customers in the utilities' low income water assistance programs.

4 In addition, because of the financial impact of any long term water supply  
5 solution that is ultimately adopted on fixed and low income customers, DRA  
6 recommends Cal Am enhance its outreach efforts to ensure all eligible customers  
7 are aware and enrolled in the PAR program. At a minimum, Cal Am should  
8 send out bill inserts on the PAR program twice a year (instead of once a year) in  
9 multiple languages and enlist local Community Based Organizations (CBOs) to  
10 help enroll eligible customers who may be unaware that this type of assistance is  
11 available.

12 Finally, DRA recommends that a review and update of the Cal Am PAR  
13 program be done in the next GRC.

14 **F. Consideration of ultimate project cost recovery**  
15 **mechanisms should occur in a subsequent phase of this**  
16 **application, or a subsequent separate application, instead**  
17 **of a GRC.**

18 The recommendations made by DRA in this report pertain only to Cal  
19 Am's request for interim rate relief, and not to any ultimate cost recovery Cal Am  
20 requests. DRA will be analyzing ultimate project costs and recovery mechanisms  
21 and may recommend an entirely different approach for ultimate cost recovery of  
22 project capital and ongoing O&M costs.

23 DRA recommends the Commission consider not only final project cost but  
24 also recovery mechanisms a subsequent phase of this application. Alternately,  
25 cost allocation issues could be considered in a subsequent separate application.  
26 This matter is too important and complex to be considered as part of a General  
27 Rate Case. The processing of rate cases for Class A water companies is on a fixed  
28 schedule which precludes sufficient time to properly evaluate final project costs  
29 and proposed recovery mechanisms.

## **Appendix A – Diana S. Brooks, Qualifications**

**Q1: Please state your name, business address, and position with the California Public Utilities Commission (CPUC).**

A1: My name is Diana S. Brooks and my business address is 505 Van Ness Avenue, San Francisco, CA. I am a Public Utility Regulatory Analyst V in the Water Branch of the Division of Ratepayer Advocates (DRA).

**Q2: Please summarize your educational background.**

I received my Bachelor of Science degree in Cybernetics from the University of California at Los Angeles (UCLA) in 1977 and a Masters of Business Administration degree from UCLA in 1982.

**Q3: Please summarize your business experience.**

A3: Prior to joining the CPUC in 1989, I taught business mathematics and statistics in the School of Business at San Francisco State University for four years. While at the CPUC, I have researched, analyzed and developed reports and testimony on various complex public policy issues in energy, telecommunications, transportation and water. I was appointed Chair of the Low Income Oversight Board (LIOB) during its formative year in 1997.

More recently, I have served as DRA's policy witness on the Cal Am Monterey/Felton district consolidation proposal, the most recent Cal Am GRC, and California Water Service (CWS) Rate Base Equalization Account (RBEA) proposal. I am the DRA Project Manager on the New Rate Case Plan. I prepared DRA's comments on the Commission's Water Action Plan. I have overseen the development of low income water rate assistance programs for CWS.

In addition to my other responsibilities, I have served as a DRA legislative liaison, advocating on behalf of ratepayers at the Legislature.

**Q4: What is your responsibility in this proceeding?**

A4: I am the DRA Project Manager and am responsible for DRA's testimony on the Coastal Water Project Special Requests #1 and #2 in this phase of the proceeding. I was assisted in the data analysis by Zara Clayton-Niederman, a graduate student intern from the UC Berkeley School of Urban and Regional Planning.

**Q5: Does this conclude your prepared direct testimony?**

A5: Yes, it does.